

**FOREMOST LEGAL ISSUES FACING CONTRACTORS**

**by**

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# **FOREMOST LEGAL ISSUES FACING CONTRACTORS**

By: Gregory M. Cokinos

## **INTRODUCTION**

Construction law is, in essence, an amalgamation of several traditional area of legal study. Specifically, the areas of contracts, real estate, labor and employment, insurance, and bankruptcy, just to name a few, are routinely present in construction law situations. Because o the somewhat litigious nature of the construction industry, however, there is significant law, both statutory and appellate cases, which have been applied to construction fact patterns.

The following synopsis is intended to familiarize you with certain key legal issues every executive in the industry should recognize. It is not meant as a replacement for legal advice regarding any specific fact pattern. Rather, it is presented in such a way as to allow you to identify these issues in your industry practice, and to allow you to recognize the legal issues inherent in these situations.

The authors highly recommend a reading of the pivocal appellate cases which are attached. Doing so should allow the reader to understand the concepts involved from a legal analysis standpoint, and, further, should give the reader an idea of what parameters his lawyer has to work with, given the legal standards imposed by the courts.

## **PART I**

### **CONTINGENT PAYMENT CLAUSES**

In the practical world of construction contracting, payment flows downhill; when the owner pays a contractor, the contractor pays the subcontractor, and the subcontractor pays the supplier. At least that is the way most players in the industry view the traditional method of payment.

However, what happens if someone in the contracting chain does not pay? The answer depends on the contractual payment clause in the contracts at issue. So called “contingent” payment clauses,” those that do not require payment downstream until payment is received are prevalent in the industry today. A typical example of a contingent payment clause is as follows:

Progress payments to the subcontractor for satisfactory performance of the subcontractor’s work shall be made no later than seven (7) days after the Contractor receives payment from the Owner for such subcontractor’s work.

Are these clauses enforceable? Can a contractor delay payment downstream indefinitely until he is paid from upstream? In the vast majority of jurisdictions in the United States, the “paid when paid” clause is deemed as a covenant regarding the time and manner of payment, rather than an absolute condition to payment. Simply stated, most jurisdictions will require a contractor to pay a subcontractor, after a “reasonable” time, regardless of whether the contractor has been paid.

However, in a few jurisdictions, including Texas, there is a divergence of case authority which might allow a true “pay if paid” clause to act as a pure condition precedent to payment.

A Texas court in a very typical conditional payment case, addressed the issue in *Gulf Construction Company v. Self*, 676 S.W.2d 624 (Tex.App.–Corpus Christi 1984, writ ref’d n.r.e.)(copy attached). This case contained the following “pay if paid” clause:

When the owner or his representative advances or pays the general contractor, the general contractor shall be liable for and obligated to pay the subcontractor up to the amount or percentage recognized and approved for payment by the owner’s representative, less the retainage required under the terms of the prime contract. Under no circumstances shall the general contractor be obligated or required to advance or make payments to the subcontractor until the funds have been advanced or paid by the owner or his representative to the general contractor.

Despite the rather strong language, the court held the payment clause was a covenant as to time and ultimately required payment to be made to the subcontractor. This represents the majority

view in most states; however, the court also stated that traditional condition precedent words such as “if,” “provided that,” or “on condition that” were not contained in the clause.

Many legal commentators have reasoned that although the *Gulf Construction* case and many cases with similar language have ultimately not enforced “pay if paid” clauses, the courts have given some credence to the notion that such a clause could be enforceable, if it were clearly and unmistakably written.

The case of *North Harris County Junior College District v. Fleetwood Const. Co.*, 604 S.W. 2d 247 (Tex. Civ. App.–Houston [1st Dist.] writ ref’d n.r.e)(copy attached) provides precedence, at least in Texas, that parties can contract to shift the risk of nonpayment. The court held the “clear evidence” in this case was the parties intended that payment be made only after full payment to the contractor.

Therefore, although “pay if paid” clauses are difficult to enforce across the county, there is a window of opportunity for such clauses to be enforced in a few jurisdictions if, but only if, those clauses are extremely clear and have the requisite conditional language. If the clause is to be enforced, it must emphasize the following issues, at a minimum:

1. payment to contractor is a condition precedent to payment to a subcontractor;
2. the subcontractor bears the risk of owner insolvency;
3. the subcontractor’s payment is to come from a fund, the sole source of which is the owner’s payment to the contractor.

If you intend to enforce a condition precedent clause, clear, thorough, and unambiguous language is necessary for even a possibility of having the clause enforced.

## NO DAMAGE FOR DELAY

Construction delays, and the damages that result, are the cause of most claims in the construction industry, both from a frequency standpoint, and from a monetary damage standpoint. However, a simple exculpatory clause known as a “no damage for delay clause” can be, and frequently is used to thwart any attempts to collect damages as a result of delays. We refer you to the landmark Texas case of *City of Houston v. R. F. Ball Construction Co.*, 570 S.W.2d 75 (Tex. Civ. App.–Houston [14th Dist.] 1978, writ ref’d n.r.e.)(copy attached). The following provision in the *Ball* case precluded the contractor from any indirect or impact delay costs due to the disruption and general hindrance of a substantial number of changes:

Delays - The Contractor shall receive no compensation for delays or hindrances to the work, except when direct and unavoidable extra cost to the Contractor is caused by the failure of the city to provide information or material, if any, which is to be furnished by the city . . . .

The essential thrust behind the “no damage for delay” cause is to allow the contractor a time extension for completion of the work, to the exclusion of any monetary damages. These clauses are usually simple and direct, and in Texas as well as most other jurisdictions, they are clearly enforceable. Colorado and Oregon, however, maintain statutes which prohibit the enforcement of these clauses on public works projects.

Should you be faced with attacking a “no damage for delay” clause in order to recover damages, there are several recognized exceptions to the enforceability of a clause such as (1) fraud, misrepresentation, or bad faith; (2) active interference by the owner with the contractor’s performance; (3) unreasonable delay, particularly delay which amounts to the abandonment of the project; and (4) delay not intended or contemplated by the parties to be governed by the provision.

Most of the case law from all jurisdictions has shown that the application of these exceptions to a “no damage delay” clause is extremely limited.

The extent of risk taken in a contract with a “no damage for delay” clause cannot be overemphasized. Owners, contractors, and everyone else involved in the process should be fully aware of this risk when bidding and/or contracting for a construction project. The old axiom “Time is Money” does not have a truer application than in the construction industry.

### INDEMNITY

No other risk shifting device has received more attention in the construction industry in recent years than the indemnity clause. In its basic form, an indemnity clause is simply an agreement by one party to assume certain risks as defined in the particular clause. Traditionally, these clauses were buried in the fine print of the contract, and crafted such that a substantial portion of the risk was shifted from the drafter of the contract to the signer of the contract, without the signer of the contract fully understanding the assumption of risk he was taking. Historically, courts had been somewhat liberal in allowing the enforcement of even craftily worded indemnity clauses to shift risks.

However, recent national trends indicate both courts and legislatures are increasing the restrictions placed on indemnity clauses. Recent history in Texas is illustrative of this trend. In 1987, the Supreme Court of Texas issued its opinion in *Ethyl v. Daniel Const. Co.*, 725 S.W.2d 705 (Tex. 1987), which, in one fell swoop, rendered void the vast majority of indemnity clauses in the industry. The financial ramifications to owners, contractors, and insurance companies were dramatic as nearly every clause then in existence was no longer enforceable.

The *Ethyl* case adopted the “express negligence” doctrine which, simply stated, requires the person attempting to shift the risk of his own negligence to another person to do so in express and clear terms.

A full copy of the *Ethyl* opinion is attached for your suggested reading. The indemnity clause in that case, which was held invalid by the court, is as follows:

Contractor shall indemnify and hold Owner harmless against any loss or damage to persons or property as a result of operations growing out of the performance of this contract and caused by the negligence or carelessness of Contractor, Contractor’s employees, Subcontractors, and agents or licensees.

While it is now clear it is possible for an indemnitee to transfer the entire risk of even his sole negligence to an indemnitor (at least under Texas law), that language must be clear, unequivocal, and set out within the four corners of the contract. Subsequent cases to *Ethyl* have refined the doctrine to increase the strictness of the test.

Indemnity clauses must now be “conspicuously” written in the contract, either set out in bold type or in contrasting type or color, in order to be enforceable. A possible exception to this rule is when the parties have actual notice of the existence of the clause.

Many trade associations have lobbied for years for the creation and expansion of anti-indemnity statutes in the construction industry. While there are statutes in existence which serve to restrict the scope and enforcement of indemnity clauses, they vary widely from state to state. Generally, there are four (4) types of anti-indemnity statutes, which can be subdivided into the following categories: (1) statutes which bar indemnification for unlawful acts; (2) statutes which bar indemnification for “sole” negligence; (3) statutes which bar indemnification for negligence; and (4) statutes which bar indemnification of design professionals.

As a result of the wide disparity between the states in anti-indemnity statutes, particular attention should be paid to the “choice of law” clauses in contracts. As an example, Texas voids indemnity agreements against the design professional’s defects, specifications, and drawings, as well as the designer’s negligence in inspections.

Further, Texas statutes bar indemnification for sole or concurrent negligence, but this prohibition is limited only to operations pertaining to a well for oil, gas, or other mineral resources. The acts specifically states that indemnification agreements in the “oil patch” are against public policy. However, the legislature has not deemed indemnification agreements in any other industry, including the construction industry, to be against that same public policy. This example of legislative inconsistency illustrates the important of determining the application of indemnity clauses in the governing state.

#### ADDITIONAL INSURED STATUS

Another contractual risk shifting tool that is currently in vogue in the construction industry is the area of naming third parties as “additional insureds” on the Commercial General Liability (“CGL”) policy of the named insured. For example, a general contractor can name the owner as an additional insured on its CGL policy. Likewise, generals may require their subcontractors to name the general as an additional insured on the subcontractor’s policy.

A certificate of insurance indicating the new party’s status as an additional insured is usually sent to confirm the contractual requirement. However, it is the policy endorsement, and not the certificate which actually confers the coverage rights and obligation on the additional insured. For this reason, it is recommended that any company requiring itself to be named as an

additional insured obtain a copy of both the CGL policy and the endorsement naming it as an additional insured.

Generally there are five (5) motives for requesting additional insured status on the CGL policy of another:

1. It gives the additional insured direct rights under the policy of the first party.
2. It may avoid the effect of standard exclusions in the additional insured's own CGL policy.
3. It may provide a partial safety net to the additional insured for the indemnity obligations of the insuring party under a hold harmless contractual agreement, particularly if that hold harmless agreement is invalidated by the courts.
4. It generally prohibits the entity procuring the insurance from obtaining subrogation rights under the additional insured.
5. It may provide the additional insured with personal injury coverage which is unavailable to the additional insured under the insuring party's contractual liability coverage.

There are several issues of concern for the person supplying the additional insurance. To do so potentially dilutes the named insured policy limits. Also, any loss covered by the policy, regardless of who is at fault, counts against the experience and history of the named insured. It goes without saying that negative claims history will result in higher premiums and possibly a cancellation of future policies.

There are also issues for the additional insured to review such as: the possible loss of control over the defense of the claim, and the increased likelihood of both coverage disputes and “other insurance” disputes.

The “other insurance” problem arises where a party is covered under both its own CGL policy and a third party’s CGL policy as an additional insured. The question, of course, is which of the two policies is treated as the primary policy for coverage purposes. There is a division of case law across the country on this issue; therefore, prudent practice dictates a review of both the “other insurance” laws in both insurance policies, and a contractual recitation of which policy should be primary.

Given the significant increase in third-party liability suits in the construction industry and the potentially dangerous atmosphere in which construction is conducted, the use of the “additional insured” scheme as a risk shifting technique is becoming common practice.

#### CONDUIT CLAUSE

A flowdown, or conduit clause, in some form or fashion is nearly always incorporated into most subcontract forms by a prime contractor. From the prime contractor’s standpoint, a flowdown clause, which contractually ties the subcontractor to the prime just as the prime is bound to the owner, is imperative. The absence of a flowdown clause can leave the prime contractor in the position of being exposed to liability, but unable to demand of the subcontractor the same performance which the owner can demand of the prime contractor.

A typical example of a flowdown clause is as follows:

The subcontractor shall assume toward the Contractor all obligations and responsibilities that the Contractor, under the prime contract, assumes toward the Owner and the architect, and the Contractor shall have the benefit of all rights,

remedies, and redress against the subcontractor that the Owner, under the prime contract, has against the Contractor.

Prime Contractors use this type of clause as an assurance that the subcontractor will produce his product to the same standards that will be acceptable to the owner. To the extent the flowdown clause is applicable to the character and quality of the subcontractor's actual work and the standards which such work must meet, subcontractors usually have little objection to the "flowing down" of those responsibilities and criteria.

However, the typical flowdown clause, much like the one quoted above, is much broader in its application since it refers globally to all obligations and all "rights, remedies, and redress." The prime contract (and all of the contract documents incorporated therein) by its very nature and purpose creates different obligations that flow from the contractor to the owner, many of which have little or no application to the subcontractor's work. Consequently, as a risk shifting device, the flowdown clause can be extremely dangerous to all parties, particularly the subcontractor, who may be accepting risks that do not appear to be directly relevant to the scope of his work.

Subcontractor associations have lobbied for the use of a "flowup" clause, if a flowdown clause is included in the subcontract. A typical flowup clause contains the following language:

The Contractor shall have the benefit of all rights, remedies, and redress against the subcontractor which the Owner, under the prime contract, has against the Contractor, and the subcontractor shall have the benefit of all rights, remedies, and redress against the Contractor which the Contractor under the prime contract, has against the Owner, insofar as applicable to the subcontract.

Use of a flowup clause increases the rights and remedies of the subcontractor, and therefore, may increase headaches for the prime contractor.

The real risk created by use of any conduit clause is the risk of ambiguity and inconsistency of interpretation which generates construction disputes both on project sites, and thereafter, in litigation.

The absence of a flowdown clause, however, may cause a disparity of the rights and obligations between the general contractor and owner, and the general contractor and subcontractor, which could only be reconciled by detailed analysis in drafting of the subcontract terms. Given the two alternatives, the authors always recommend the use of some sort of conduit clause. However, because of their inherent ambiguity reliance on this type of clause as a sole means of recovery or shifting risk, is tenuous at best.

### LIQUIDATED DAMAGES

Historically, many construction contracts have employed a liquidated damage clause as a remedy for a potential breach of the contract. This type of clause is simply an agreed upon sum which is to be deducted from the final contract price for each day that the contractor is late, beyond the contractually required completion date. This type of clause is usually feared by contractors, and used as a sword by owners in coming to a final resolution as to final contract payments.

However, a liquidated damage clause will only be enforceable if the liquidated amount is a “reasonable approximation” of the probable loss that will be caused by a delay. Further, the damage caused by the delay may be difficult or impossible to determine. If these criteria are not met, the liquidated damage clause may be considered to be a penalty against the contractor and thus would be unenforceable under Texas law. We refer you to the Texas case of *Loggins Construction Co. v. Stephen F. Austin State University Board of Regents*, 543 S.W.2d 682 (Tex. Civ. App.-Tyler 1976, writ ref’d n.r.e.). The Court, citing previous rules in applicable law,

stated that the liquidated damages provision was a penalty and therefore unenforceable, because the liquidated damage amount did not approximate the actual damages suffered by the owner.

Simply stipulating to an amount of damages in a contract is not enough to make a liquidated damage clause enforceable. The amount must be a reasonable forecast of the actual damages to be suffered by the owner in a case of a breach, and the actual damages must be very difficult to accurately verify. Under these definitional concepts of the law, anyone desiring to fight a liquidated damage clause automatically has weaponry in its arsenal.

The existence of a liquidated damage clause in a prime contract does not necessarily mean that the clause is enforceable against a subcontractor by the general contractor. If the subcontract does not reference the liquidated damage clause, and the subcontractor has no knowledge of the existence of such a clause, the general contractor will not be able to enforce this clause against the subcontractor even though the delays were a result of the subcontractor's performance. However, the general contractor, assuming his subcontract is worded properly, may still be able to recover actual delay damages from the subcontractor.

The attitude of most contractors toward a liquidated damage clause is one of fear and loathing. However, the authors submit that in many instances, the liquidated damages clause is the contractor's best friend. Delays are one of the few constants in the construction industry and, although rarely will a contractor admit that a delay is actually his fault, establishing proof that the delay is the owner's fault is sometimes extremely difficult and expensive, if not impossible. More importantly, in the age of expert economic testimony and the high finance generally employed to develop, engineer, and construct, in most instances the actual damages suffered by an owner for delay will be substantially more than the amount liquidated in the contract. Intelligent contractors

recognizing a “low” or even reasonable liquidated damage number should embrace it wholeheartedly and make sure that the clause itself is written to allow the maximum chance of it being enforceable.

### DIFFERING SITE CONDITIONS

A differing site conditions clause, also known as a concealed or changed conditions clause, is a contractual vehicle used to determine responsibility for unexpected and unforeseen conditions encountered on a project. Examples include poor subsurface conditions such as rock, or a water table, or such conditions as unexpected conduit inside existing walls, etc. A differing site conditions clause, or the lack thereof, can have significant impact on which party will bear the financial burden of changed conditions on the project site.

Contractual provisions take several forms in attempting to shift the risk involved for differing site conditions. For example, the clause found in AIA document A-201, Section 4.3.4 (1997 Ed.), set out in its entirety below, includes definitions of what are traditionally known as “Type 1 and Type 2” claims. The clause is as follows:

Section 4.3.6. Claims for Concealed or Unknown Conditions. If conditions are encountered at the site which are (1) subsurface or otherwise concealed physical conditions which differ materially from those indicated in the Contract Documents or (2) unknown physical conditions of an unusual nature, which differ materially from those ordinarily found to exist and generally recognized as inherent in construction activities of the character provided for in the Contract Documents, then notice by the observing party shall be given to the other party promptly before conditions are disturbed and in no event later than 21 days after first observance of the conditions. The Architect will promptly investigate such conditions and, if they differ materially and cause an increase or decrease in the Contractor’s cost of, or time required for, performance of any part of the Work, will recommend an equitable adjustment in the Contract Sum or Contract Time, or both. If the Architect determines that the conditions at the site are not materially different from those indicated in the Contract Documents and that no change in the terms of the Contract is justified, the Architect shall so notify the Owner and Contractor in

writing, stating the reasons. Claims by either party in opposition to such determination must be made within 21 days after the Architect has given notice of the decision. If the Owner and Contractor cannot agree on an adjustment in the Contract Sum or Contract Time, the adjustment shall be referred to the Architect for initial determination, subject to further proceedings pursuant to Paragraph 4.4.

For those involved in Federal contracting, the substance of the AIA clause printed above is almost identical to the standard Federal “Differing site Conditions” clause found in Federal contracts and the Federal Acquisition Regulations (FAR).

A Type 1 claim typically involves a project site condition which “differs materially” from those indicated in the contract documents. As an example, the contract drawings show no pipeline or sewer located in the area to be excavated in which the slab is going to be located; however, during actual excavation, abandoned sewer line is found along with abandoned foundation.

A Type 2 claim typically involves site conditions of an unknown and unusual nature which differ materially from those ordinarily found to exist. An example of a Type 2 claim might be the existence of a subsurface water table in a geographic location where an occurrence of this nature is extremely rare. Both types require the condition to be materially different from what was expected. Generally, only on-site, project specific conditions are covered. Weather conditions are generally excluded.

As a general proposition, Type 1 claims are much easier to prove and consequently meet with much less resistance from the ultimate payer. Type 1 claims are proven by showing a difference between the actual conditions of the site and the conditions as represented in the construction documents. No showing of owner negligence or intentional malfeasance is necessary for a recovery.

Conversely, Type 2 claims are difficult to prove, difficult to negotiate, and generally do not produce nearly the amount of monetary concessions as are found under Type I claims. Contractors must show the condition was unknown, unusual, and not reasonably foreseeable after a review of the documents, the site, and consideration of the general experience reasonably to be expected of a contractor familiar with work of a similar nature.

Another contractual risk shifting device similar to a differing site conditions clause is known as a “site investigation” clause. These clauses typically contain a representation that the contractor or subcontractor has visited the site and has thoroughly familiarized himself with all aspects of the project and the construction thereof. This type of clause has the effect of shifting the entire risk of differing site conditions onto the contractors, to the exclusion of the owner. Theoretically, this type of clause should increase the contractor’s bid to do the work in that he is accepting substantial risks without hope of recovered compensation for concealed conditions at the project site.

For your recommended reading, we refer you to the cases of *Stuyvesant Dredging Co. v. United States*, 834 F.2d 1576 (1987) and *Shank-Artukovich v. United States*, 848 F.2d 1245 (1988). These cases represent “typical” Type 1 and Type 2 differing site condition cases. As a general rule, differing site condition claims will be most successful if there is early detection of the changed condition, and early notice of the change to the appropriate authorities. The owner’s right to inspect and verify the changed condition is of paramount importance. Additionally, strict accounting of the cost and damage incurred because of the changed condition is critical to the successful resolution of a differing site conditions claim.

## DISPUTE RESOLUTION

For a number of years, Alternative Dispute Resolution (“ADR”) techniques have been utilized to successfully, quickly and in most cases inexpensively resolve disputes between parties. ADR comes in many forms, including, mediation, moderated settlement conferences and arbitration. ADR is generally the subject of a day long seminar on its own, but I will briefly address the subject. Mediation and moderated settlement conferences are non-binding structured negotiations for purposes of settling a dispute. Arbitration, on the other hand, is a binding final resolution by a neutral decision maker(s), typically a lawyer or industry professional. If properly handled, arbitration is a cheaper alternative to litigation. More importantly, ADR typically allows a party more control in ultimately resolving their differences, particularly the timing of claim resolution and ultimate trial/hearing in the event one is necessary. The author encourages parties to enter into some sort of ADR at any stage of a dispute in an effort to quickly resolve any difference you may have with the party in which you are doing business.

## **PART II**

### MECHANIC’S AND MATERIALMAN’S CLAIMS IN TEXAS

Any discussion of construction contracting and the applicable governing law must necessarily include discussions on mechanic’s liens and bond claims. In addition to whatever can be bargained through contractual negotiations, mechanic’s liens are one of the few areas wherein contractors and material suppliers can gain a measure of security for their indebtedness. As opposed to some other types of commercial transactions, the security is statutorily granted and defined. Consequently, project owners, their sureties and lenders are confronted with potential clouds on title and/or claims for monetary payment.

Every state has its own set of mechanic's and materialman's lien laws, some more unique than others. While significant strides have been made in recent years to simplify the procedures, Texas lien laws are still complex and convoluted. Contractors and their lawyers must have a good grasp of the statutory schemes and provisions to have any hope of either securing indebtedness or defending against indebtedness incurred during the construction process. This paper will focus primarily on the mechanism for obtaining a statutory mechanic's lien on private commercial work and perfecting a statutory bond claim on public work in Texas but does not include any aspect of claims or liens against residential construction projects.

### BACKGROUND AND LEGAL FRAMEWORK

#### What is a Lien?

A lien is a claim on the property of another as security for the payment of a debt. Generally the lien secures payment for labor or material furnished for the construction or repair of a house, building, or fixtures. Under the statutory scheme, it also extends to improvements, land reclamation from overflow or railroads, and to each lot of land necessarily connected therewith. The lien does not extend to abutting sidewalks, streets and utilities that are public property. Also, demolition or removal of improvements or structures are generally not lienable unless it can be considered "clearing of the land" as specifically defined by Section 53.001(2)(B) of the Texas Property Code. Additionally, mechanic's liens do not attach to personal property. Construction improvements generally are "fixtures" and are considered permanent improvements to real property which may have a mechanic's lien recorded against them.

## What is a Statutory Lien?

Chapter 53 of the Texas Property Code is the “nuts and bolts” of construction lien law in Texas. It provides for the statutory mechanic’s and materialman’s lien on commercial private work as well as homesteads, and covers labor performed, materials supplied, and specially fabricated materials ordered. It also provides for the application of bonds and claims against those bonds. Chapter 53 was codified in 1984 from the then existing Article 5452, et seq., of the Texas Revised Statutes, commonly known as the “Hardemann Act.”

Basically, any person who labors, specially fabricates material or furnishes labor or materials for construction or repair of a house, building or improvement is entitled to a lien in this state. In 1989 the Texas Property Code was amended to allow an architect, engineer or surveyor who prepares a plan or plat in connection with the proposed construction or repair of improvements on real property to also have a lien on the property under certain conditions.

Chapter 2253 of the Texas Government Code, the 1993 recodification of the old “McGregor Act” (Article 5160, Texas Revised Civil Statutes), provides statutorily created protection for subcontractors and material suppliers who provide labor or materials to public work projects. This statute requires a governmental entity to obtain a performance and payment bond from the prime contractor upon entering into a public work contract for more than \$25,000.00. The payment bond is solely for the protection and use of the beneficiaries who have a direct contractual relationship with the prime contractor or a subcontractor to supply labor or material to the public work project.

Chapter 53 of the Texas Property Code and Chapter 2253 of the Texas Government Code outline the specific requirements a claimant must comply with to perfect a claim or lien on public

or private projects. The claimant's status as a contractor, subcontractor or supplier and the type of project to which the labor and/or materials were supplied, dictates which statutory scheme is applicable to the particular situation.

It must be determined at the outset whether the project to which the materials and/or labor were supplied is a public project or a private project. It must also be determined whether a bond has been provided by the prime contractor or a lower tier subcontractor, depending on the claimant's status. Sections 53.001-.211 of the Texas Property Code are applicable to private projects. Projects constructed for the benefit of state and local governments are covered by Sections 2253.001-22.53.079 of the Texas Government Code. Generally, federal government projects will be covered by the Miller Act, 40 U.S.C.A. § 270(a)-(c) and will not be covered in this paper.

#### Projects Capable of Being Liened

A mechanic's or materialman's lien extends only to private property. Public property cannot be liened in this state. Consequently, claimants who have performed work or supplied material to public work projects must perfect their bond claim under the requirements of the Texas Government Code to protect their interests.

However, a derivative claimant (anyone below an original contractor) may have a lien on the money, bonds, or warrants due to the original contractor on a public project if, but only if, the prime contract for the public improvements does not exceed \$25,000. This specialized lien regarding public contracting attaches only to funds, monies, and bonds due to be paid to an original contractor. No lien can be placed against a public structure in Texas and therefore public

property cannot be sold at a foreclosure sale. We will not cover in this summary the requirements for perfection of this specialized lien on public work monies.

### What is Lienable?

Section 53.022(a)-(d) of the Texas Property Code defines the type of property to which a lien extends as:

1. a house, building, fixtures, or improvements, the land reclaimed from overflow, or the railroad and all of its properties, and to each lot of land necessarily connected or reclaimed.
2. a lien does not extend to abutting sidewalks, streets, and utilities considered public property;
3. a lien against any property located in a city, town or village extends to each lot on which the house, building or improvement is situated or in which the labor was performed; and
4. a lien against rural property not located in a city, town or village extends to not more than 50 acres on which the house, building or improvement is situated or on which the labor was performed.

Remember as a general rule, demolition and removal of structures do not give rise to a mechanic's lien.

### Eligible Claimants

Eligible claimants can be divided into three categories—original contractor, subcontractor/material supplier, or architect/engineer. Generally, any person or entity who

performs labor, specially fabricates material, or furnishes labor or materials for construction or repairs on private property is entitled to a lien, if the appropriate statutory requirements are met.

An original contractor or a prime contractor (also referred to as General Contractor, but a general contractor is not necessarily a prime contractor) is one who contracts directly with the owner of the property or the governmental entity for whom the work is performed. A subcontractor is a person, firm, or corporation that provides labor and/or materials to fulfill an obligation to the prime contractor and who has performed work required by the prime contract or public work contract.

Subcontractors who work for or under Subcontractors are commonly known as "Sub-Subs." Material Suppliers can supply project materials either to original contractors, subcontractors or sub-subs. A material supplier who supplies directly to the project owner is a "Prime Contractor" for purposes of the lien law.

Subcontractors, Sub-Subs, and most material suppliers are also sometimes referred to as "derivative claimants" because their claim is derived from the prime contractor's contract or claim, rather than directly with the property owner.

#### HOW TO PERFECT A LIEN ON A PRIVATE CONSTRUCTION PROJECT

A grasp of the statutory scheme is essential in order to properly and timely perfect or, alternatively, defend against a mechanic's lien. A thorough understanding of the time and notice elements prescribed by the Property Code are crucial.

#### Identify the Project

There are two threshold questions to ask when determining lien rights for the individual or entity on a construction project. The first question is, "What type of project is this?" Is the

project a public project, for a state, municipality, school district, or other governmental entity, or is it a private project? The answer to this question will determine which law is applied to the particular claim. Chapter 53 of the Texas Property Code applies to private projects; Chapter 2253 of the Texas Government Code applies to public projects.

### Identify the Claimant

The second and equally important threshold question is, "Who is the claimant?" More appropriately, is the claimant a prime contractor, subcontractor, or a sub-sub or material supplier to a subcontractor? The answer to this question will determine what type of "pre-lien" notices are required to be given in order to perfect a mechanic's lien on a private project.

It is critical that you are able to determine where the claimant fits in the contractual hierarchy of the project. An incorrect assumption as to the claimant's position in the contractual chain could lead to improper notices being sent, or proper notices being sent at the wrong time, or to the wrong person, any of which will jeopardize the claimant's ability to effectively lien the project. Obviously, the property owner and the surety, if applicable, will also need to determine this information in their defense of any attempted claim or lien.

#### 1. Laborer or Material Supplier

A lien claimant can be any person who labors, specially fabricates material, or furnishes labor or materials for construction or repair of a house, building or improvement, if the person labors, specially fabricates the material, or furnishes the labor or materials under or by virtue of a contract with the owner or the owner's agent, trustee, receiver, contractor or subcontractor. Tex. Prop. Code Ann. § 53.021(a) (Vernon 1995). It should be noted that specially fabricated materials are not required to be delivered before the fabricator is entitled to a lien.

## 2. Architects, Engineers, and Surveyors

Additionally, in accordance with the 1995 amendments to Section 53.021 of the Texas Property Code, an architect, engineer, or surveyor who prepares a plan or plat in connection with the proposed construction or repair of improvements on real property has a lien on the property if he does so by virtue of a written agreement with the property owner in connection with actual or proposed design, construction, or repair of improvements. The time of inception of an architect's, engineer's, or surveyor's lien is the date of recording of the lien affidavit.

### Time of Supplying Labor/Materials

Under the statutory scheme it is critical to determine the month in which work was performed or material was delivered. The day of the month that the labor was performed or the material was supplied is irrelevant for purposes of filing a bond or lien claim. As long as the material is supplied or labor was performed during a particular month, notice must be given by the appropriate deadline as outlined in the Texas Property Code notice requirements for each month in which all or part of the claimant's labor was performed or material was delivered.

### Notice Requirements

After a determination has been made as to what type of project the lien claim involves, and where the claimant fits in the contractual chain, the next step is to determine what notices are required to be sent, to whom, and by when.

For all claimants other than an original contractor, Texas employs a statutory scheme wherein written notice is required to be given to the property owner and the original contractor. There are, however, different time limits required depending on the type of claimant. Also, in order to "trap funds" in the owner's possession which he has not as yet paid to the prime

contractor, the notice requires specific language. Following is the time and content requirements of the notices specified for valid perfection of a mechanic's lien on private projects.

1. Original Contractor

Original contractors do not have any "pre-lien" notice requirements. They must, however, notify the owner of the lien within one (1) day of the filing of the actual lien affidavit. Tex. Prop. Code Ann. § 53.055 (Vernon 1998).

2. Subcontractor/Supplier

If the lien claim arises from the debt incurred by the original contractor (i.e., either the original contractor's subcontractor or a material supplier *in privity* with the original contractor), the claimant must give notice to the owner or reputed owner and the original contractor not later than the fifteenth day of the third month following each month in which all or part of the claimant's labor was performed or material or specially fabricated material was delivered. Tex. Prop. Code Ann. § 53.056(b) (Vernon 1995). The notice must be sent by registered or certified mail to both the owner and the prime contractor at the last known business or residence address. Tex. Prop. Code Ann. § 53.056(e) (Vernon 1995).

Additionally, to authorize the owner to withhold funds ("fund trapping"), the notice to the owner must state that if the claim remains unpaid, the owner may be personally liable and the owner's property may be subjected to a lien unless (i) the owner withholds payment from the contractor for payment of the claim; or (ii) the claim is otherwise paid or settled. Tex. Prop. Code Ann. § 53.056(d) (Vernon 1998).

### 3. Sub/Subcontractor or Supplier

If the lien claim arises from a debt incurred by a subcontractor, a sub/subcontractor or material supplier who is *not in direct contractual privity* with the prime contractor, the claimant must also give the original contractor written notice of the unpaid balance not later than the fifteenth day of the second month following each month in which all or part of the claimant's labor was performed or material delivered. Tex. Prop. Code Ann. § 53.056(b) (Vernon 1995). This notice must be followed with a notice to the owner or reputed owner and the original contractor not later than the fifteenth day of the third month following each month in which all or part of the claimant's labor was performed or material or specially fabricated material was delivered. This "two (2) notice" process for second tier derivative claimants must be followed to perfect a lien claim.

The "second month" notice for sub/subs and material suppliers to subcontractors is the statutory requirement most often responsible for mechanic's lien claims being unperfected. The payment stream on a construction project naturally flows downhill. The prime contractor does not pay the sub until the owner pays the prime; likewise, the subcontractor does not pay his suppliers or sub/subs until he receives payment from the prime. This "standard payment" system very likely will exceed the time period required for a sub/sub or material supplier to file the required second month notice.

It is recommended, therefore, that second tier derivative claimants establish a billing and notice system as part of a standard routine in order to assure that timely notices are sent before the deadline. In fact, second tier claimants should take advantage of Section 53.056(f) of the Texas Property Code, which allows a copy of the claimant's usual statement or billing to suffice as

notice. Failure to send the notice before the deadline will result in a claim that is not perfected, at least for the months in question.

The attached Timetable Chart shows the dates by which both the “second month” and “third month” notices must be sent.

#### Contents of Notice

The "second and third month" notices must be sent by registered or certified mail, return receipt requested and addressed to the owner, reputed owner or the original contractor at the last known business or residence address and contain:

1. The name and business address of the claimant;
2. The name and business address of the entity to whom the claimant provided the labor or material;
3. The name and address of the project for which the labor or material was provided;
4. A description of the labor and/or materials furnished; and
5. The requisite language to the owner in order to trap funds (i.e., "If the claim remains unpaid, the owner may be personally liable and the owner's property may be subjected to a lien unless (1) the owner withholds payment from the contractor for payment of the claim; or (2) the claim is otherwise paid or settled." Tex. Prop. Code Ann. § 53.056(d) (Vernon 1998).

A copy of the monthly statement or billing is usually sufficient in lieu of a claim letter; however, failure to include the requisite "fund trapping" language to the owner could diminish the effectiveness of the claim. For this reason, it is recommended the notice to the owner contain a copy of the normal billing as an attachment.

## Effects of Notice

Upon receipt of the requisite notices, the Texas Property Code states the property owner "may" withhold from payments to the original contractor an amount necessary to pay the claim for which he receives notice. Tex. Prop. Ann. Code § 53.081(a) (Vernon 1998). The word "may" is misleading in terms of direction to the owner. A sophisticated owner "will" withhold payment or possibly suffer severe consequences which will be discussed below.

Unless the claim is settled, discharged, indemnified, or determined to be invalid by final judgment of a court, the owner shall retain the funds withheld until the time for filing the affidavit of mechanic's lien has passed or, if the lien affidavit has been filed, until the lien claim has been satisfied or released. Tex. Prop. Code Ann. § 53.082 (Vernon 1995).

To protect his lien rights, a derivative claimant, through the appropriate statutory notice, must either "trap" funds in the owner's hands or, through proper notice and lien affidavit, claim his pro-rata share of the statutory retainage fund. Tex. Prop. Code Ann. §§ 53.056, 53.057, and 53.081 (Vernon 1995). Unless the subcontractor succeeds in trapping funds with the owner pursuant to the above-referenced statutes, his recourse of payment is limited only to his share of the ten percent (10%) statutory retainage fund that the owner must maintain until the project is completed.

## Owner Requirements - Retainage, Trapped Funds

During the progress of work under an original contract for which a mechanic's lien may be claimed and for thirty days after the work is completed, the owner of the project, its agent, trustee, or receiver is required to withhold a certain percentage of payment and, if proper notice is given, to withhold amounts claimed to be due by derivative claimants.

1. Retainage

The owner is required to retain:

- a. Ten percent (10%) of the total contract price of the work; or
- b. Ten percent (10%) of the value of the work, measured by the proportion that the work performed bears to the work to be completed, using the contract price or, if there is no contract price, using the reasonable value of the work completed. Tex. Prop. Code Ann. § 53.101 (Vernon 1995).

These retained funds are for the benefit of artisans, mechanics, and other persons who perform labor, service, or furnish material, labor, or specially fabricated material for any contractor, subcontractor, agent, or receiver in performance of the work for the project. Tex. Prop. Code Ann. § 53.102 (Vernon 1995).

A claimant has a lien on these retained funds if the claimant:

- a. sends timely and proper notices as required; and
- b. files a lien affidavit not later than the 30th day after the work is completed.

Tex. Prop. Code Ann. § 53.103 (Vernon 1995).

If the owner fails or refuses to retain the required 10%, the claimants who perfect their statutory notices have a lien, at least to the extent of the amount that should have been retained by the owner from the original contract under which they are claiming, against the house, building, structure, fixture, or improvement, and all of its properties and against the lot or lots of land necessarily connected. Tex. Prop. Code Ann. § 53.105 (Vernon 1995).

No cases have yet opined on the meaning of the language "at least to the extent of the amount that should have been retained." Consequently, property owners who fail to retain 10%

could potentially be liable for the full amount of any and all duly perfected and recorded mechanic's liens on their property, even above the 10% threshold.

## 2. Trapped Funds

Except for the contractual retainage amount, the owner is not liable for any amount paid to the original contractor before receipt of the notice authorizing the owner to withhold funds. The owner can be held liable, and the owner's property subject to a claim for any money paid to an original contractor after the owner was authorized to withhold funds. Tex. Prop. Code Ann. § 53.084 (Vernon 1998).

The danger to the owner for failing to withhold "trapped funds" cannot be overemphasized. An owner has to "pay twice" only once to understand the full measure of his exposure. The owner's liability, however, is subject to the receipt of the required notices, the claimant's securing and perfecting the lien, and reducing the claim to a final judgment. It should be noted that the owner's liability for failure to withhold the funds is in addition to any retainage amount required. Tex. Prop. Code Ann. § 53.084(a)-(b) (Vernon 1998).

### Notice of Retainage Agreement

A derivative claimant who has an agreement with an original contractor or subcontractor which provides for retainage to be withheld, may give a notice at the front end of the project to the owner and the original contractor. The notice of the retainage agreement must be given by the fifteenth day of the second month following the delivery of materials or the performance of labor by the claimant that first occurs after the claimant has agreed to the contractual retainage. If sent, this notice must contain the sum to be retained, the due date or dates, if known, and a general indication of the nature of the agreement. If a claimant gives this additional "retainage notice,"

he is not required to give any other notice as to the retainage. Tex. Prop. Code Ann. § 53.057 (Vernon 1998).

#### Lien Affidavit on Retained Funds

To obtain a lien on retained funds, however, the claimant must not only send notices required by either Section 53.056 (the second month and third month notices) or Section 53.057 (the retainage notice) of the Texas Property Code, but also must file his lien affidavit not later than the 30th day after the work is completed. Tex. Prop. Code Ann. § 53.103 (Vernon 1995).

This "30-day" time period should be monitored closely as it is significantly shorter than the potential time to file a mechanic's lien outlined in Section 53.052 of the Texas Property Code. Section 53.052 allows a lien claimant to file an affidavit by the "fifteenth day of the fourth month after the day on which the indebtedness accrues." The potential conflict between the deadlines of Section 53.103 ("30th day after the work is completed") and Section 53.052 ("15th day of the fourth month after indebtedness accrues") has, to date, not been addressed by Texas courts.

#### Specially Fabricated Materials

Specially fabricated materials are generally defined as those materials fabricated for use as a component of the construction or repair so as to be reasonably unsuitable for use elsewhere. Tex. Prop. Code Ann. § 53.001(12) (Vernon 1998). In common practice, specially fabricated materials are usually items that must be fabricated for the particular project in question and are usually fabricated at a location other than the project site.

Section 53.058 of the Texas Property Code governs lien notice requirements for specially fabricated materials. A claimant who specially fabricates materials that ultimately are not delivered to the project must give notice under this section for his lien to be valid. The claimant

must give the owner or reputed owner notice not later than the fifteenth (15th) day of the second month after the month in which the claimant receives and accepts the order for the material. Therefore, a special fabricator's notice is to be given on the front end of his contractual obligation.

If the indebtedness to be incurred is by a person other than the original contractor, the special fabricator claimant must also give notice within the same time period to the original contractor.

The contents of the notice must contain the following:

1. a statement that the order has been received and accepted; and
2. the price of the order.

Notwithstanding the above, if the specially fabricated materials actually are delivered to the job site, then the claimant becomes a "normal" claimant and is required thereafter to give notices pursuant to Section 53.056 of the Texas Property Code (the second month and third month notices, as applicable).

#### When to File Lien Affidavit

In addition to "perfecting" the mechanic's lien by sending the required pre-lien notices, the claimant must also properly and timely record the lien affidavit itself. Proper and timely notices are worthless, on a non-bonded project, if the actual mechanic's lien is not filed.

Any person claiming a lien on private property must record a lien affidavit with the County Clerk of the county in which the property is located not later than the fifteenth day of the fourth calendar month after the day on which the "indebtedness accrues." Tex. Prop. Code Ann. § 53.052 (Vernon 1998). Refer to the Timetable Chart for a listing of these time deadlines.

The determination of accrual of indebtedness is statutorily defined and it varies for different classes of claimant.

1. Original Contractors

For purposes of filing a lien affidavit, indebtedness accrues to an original contractor on the last day of the month in which the original contractor or the owner receives a written declaration by the other party to the original contract stating that the original contract has been terminated, or on the last day of the month in which the original contract is completed, finally settled or abandoned. Tex. Prop. Code Ann. § 53.053(b) (Vernon 1998). This definition can and does create potential ambiguity, particularly over when the contract was "completed, finally settled, or abandoned." As a general proposition, original contractors should not push the envelope on its lien filing deadline.

2. Derivative Claimants

Indebtedness to a subcontractor or material supplier who has furnished labor or material to the original contractor or another subcontractor accrues on the last day of the last month in which the labor was performed or the material furnished. Tex. Prop. Code Ann. § 53.053(c) (Vernon 1998). This is a much simpler definition, and one less fraught with potential argument.

3. Specially Fabricated Material Supplier

Indebtedness for specially fabricated material accrues (1) on the last day of the last month in which materials were delivered; (2) on the last day of the last month in which delivery of the last of the material would normally have been required at the job site; or (3) on the last day of the month of any material breach or termination of the original contract by the owner or contractor,

or of the subcontract under which the specially fabricated material was furnished. Tex. Prop. Code Ann. § 53.053(d) (Vernon 1995).

#### Contents of Lien Affidavit

An affidavit must be signed by the person claiming the lien or by another person on the claimant's behalf and must substantially contain:

1. A sworn statement of the amount of the claim;
2. The name and last known address of the owner or reputed owner;
3. A general statement of the kind of work done and materials furnished by the claimant and, for a claimant other than an original contractor, a statement of each month in which the work was done and materials furnished for which payment is requested;
4. The name and last known address of the person by whom the claimant was employed or to whom the claimant furnished the materials or labor;
5. The name and last known address of the original contractor;
6. A description, legally sufficient for identification of the property sought to be charged with the lien; and
7. The claimant's name, mailing address, and, if different, physical address; and
8. For a claimant other than an original contractor, a statement identifying the date each notice of the claim was sent to the owner and the method by which the notice was sent.

The affidavit must be signed by a person claiming the lien or by another person on the claimant's behalf, and the claimant may attach to the affidavit a copy of any applicable written

agreement or contract and a copy of each notice sent to the owner. Tex. Prop. Ann. Code § 53.054(a)-(b) (Vernon 1998).

It is important to note that the claimant must sign a jurat instead of an acknowledgment on the lien affidavit. Unlike an acknowledgment, a jurat indicates that the claimant is making a sworn statement of his claim. Failure to include a jurat renders the mechanic's lien claim invalid. *Sugar Land Business Center Ltd. v. Norman*, 624 S.W.2d 639, 641 (Tex. Civ. App.--Houston [14th Dist.] 1981, no writ).

#### Notice of Lien Filed

After filing the lien affidavit, the claimant must send a copy of the affidavit by registered or certified mail to the owner or reputed owner at the owner's last known business or residence address not later than one (1) business day after the date the person files the affidavit. Tex. Prop. Code Ann. § 53.055(A) (Vernon 1998).

Additionally, if the person filing the lien is not an original contractor, the lien claimant must also send a copy of the affidavit to the original contractor at his last known business address within the same time period. Tex. Prop. Code Ann. § 53.055(b) (Vernon 1998).

#### Time to File Suit

Suit to foreclose a statutory lien must be filed within two (2) years after the date the lien affidavit was filed or within one (1) year after completion of the work under the original contract under which the lien is claimed, whichever is later. Tex. Prop. Code Ann. § 53.158 (Vernon 1998).

A recent case has held that the statute of limitations for filing suit on a constitutional lien is four (4) years. *Hoarel Sign Co. v. Dominion Equity Corp.*, 910 S.W.2d 140, 144 (Tex. App.--

Amarillo 1995, writ denied). This may give some relief to the original contractor who was tardy in suing to foreclose his statutory lien, or if he has not perfected his statutory lien.

### CONSTITUTIONAL LIEN

A typically overlooked weapon for original contractors is the lien allowed by the Constitution of the state of Texas. It has long been established in Texas that constitutional liens are available only to those persons in direct contractual privity with the owner. *Horan v. Frank*, 51 Tex. 401 (1879). The end result is the original contractor has an automatic lien if he is not paid.

Article 16, section 37 of the Texas Constitution provides:

Mechanics, artisans and materialmen, of every class, shall have a lien upon the buildings and articles made or repaired by them for the value of their labor done thereon, or materials furnished therefor; and the legislature shall provide by law for the speed and efficient enforcement of said liens.

TEX. CONST. art. XVI, § 37. Constitutional liens are in addition to liens provided by statute in this state. Subcontractors and suppliers who do not contract directly with the owner must file a statutory lien or bond claim to protect their interests. These derivative claimants (anyone below an original contractor) do not have a right to a constitutional lien in Texas as that right is reserved only for an original contractor.

Constitutional liens are self-executing; therefore, compliance with statutory notices and filing requirements is not necessary. *Hayek v. Western Steel Co.*, 478 S.W.2d 786, 790 (Tex. 1972). This type of lien does not require any particular form of notice or filing of a lien affidavit to preserve the claimant's rights. However, a constitutional lien cannot be asserted against a good faith purchaser for value of the property unless the purchaser has actual or constructive knowledge of the lien claim. For this reason, it is strongly recommended that a lien affidavit claiming a

constitutional lien be filed with the county records where the property in question is located to preserve any such claim against a subsequent good faith purchaser for value.

The constitutional lien contains no provisions for the recovery of attorneys' fees. However, Sections 38.001(1)-(3) of the Texas Civil Practice and Remedies Code does provide for the recovery of attorneys' fees "if the claim is for rendered services, performed labor, or furnished material."

It should also be noted that many types of construction work do not fall within the meaning of "buildings and articles" and are not subject to constitutional liens. As an example, landscaping and other similar work do not fall within the definition of "buildings and articles" and as such will require perfection of a statutory lien or appropriate bond claim to protect the claimant's interests. *Campbell v. City of Dallas*, 120 S.W.2d 1095, 1097 (Tex. Civ. App.--Waco 1938, writ ref'd).

Notwithstanding the foregoing, original contractors should not rely on the constitutional lien to protect their interests. Original contractors should always perfect a statutory lien or bond claim in order to preserve their rights and claims. Constitutional liens should be used only as a last resort when the prime contractor fails to perfect its statutory lien or bond claim.

#### BOND CLAIMS ON PUBLIC WORK PROJECTS

The Texas Legislature has provided a remedy by which a contractor or a supplier on a public work project may maintain a suit against a prime contractor and its surety. As previously stated, Section 2253.021 of the Texas Government Code requires a governmental entity to obtain a performance and payment bond from the prime contractor upon entering into a public work contract for more than \$25,000.00. The statute further provides that if payment is not received before the 61st day after notice of the claim is mailed, a payment bond beneficiary that has provided labor or material under a public work contract for which a payment bond is furnished

may sue the principal or surety, jointly or severally, on the payment bond without the necessity of further notice. Tex. Gov't Code Ann. § 2253.073(a) (Vernon 1998).

As outlined above, a claimant must (1) first identify the project, (2) identify the claimant and (3) identify the month in which the labor was performed or material was delivered. Once it is established that the project is a public work project then the following notices must be filed with the prime contractor and its surety. Notice of a claim is a prerequisite to filing suit on a payment bond.

Refer to the Timetable Chart for the dates by which these notices must be sent.

#### Notices to Be Filed with the Prime Contractor and Its Surety

##### 1. Laborers

Any individual mechanic or laborer who furnished labor for a public work project must give notice to the prime contractor and its surety or sureties by the 15th day of the third month following each month in which the labor was performed. Written notices of the claim must be mailed by certified or registered mail. The notice must contain a sworn statement of account stating in substance that the amount claimed is just and correct and that all just and lawful offsets, payments and credits known to the affiant have been allowed. Such statement of account must include the amount of any retainage or retainages applicable to the account that have not become due. Tex. Gov't Code Ann. § 2253.041 (Vernon 1998).

##### 2. Subcontractor

Any subcontractor who has furnished labor or supplied materials or both to a public work project must give notice to the prime contractor and its surety or sureties of unpaid bills on or before the 15th day of the third month following each month in which the labor was performed or material was delivered for which such claim was made. Written notices of the claim must be mailed by certified or registered mail. The notice must contain a sworn statement of account

stating in substance that the amount claimed is just and correct and that all just and lawful offsets, payments and credits known to the affiant have been allowed. Such statement of account must include the amount of any retainage applicable to the account that has not become due. Tex. Gov't Code Ann. § 2253.041 (Vernon 1998).

3. Sub/Subcontractor or Supplier

- a. Sub-subcontractors or suppliers who do not have a direct contractual relationship with the prime contractor are required to give two notices for unpaid claims.
- b. The first notice must be given to the prime contractor on or before the 15th day of the second month following each month in which public work labor was performed or material delivered, that payment therefor has not been received. Such notice shall be given by certified or registered mail. A copy of the statement sent to the subcontractor is sufficient notice. If a statement is not available, the notice should generally include the name of the party for whom the labor was done or performed or to whom the material was delivered, the approximate dates of performance and delivery, and describing the labor or materials or both in such a manner so as to reasonably identify said labor or materials or both and amount due therefor. Also, generally itemize the claim and attach true copies of documents, invoices or orders sufficient to reasonably identify the labor performed or material delivered for which the claim is being made. Tex. Gov't Code Ann. § 2253.047 (Vernon 1998).
- c. The second notice is required to be given to the prime contractor and its surety or sureties on or before the 15th day of the third month following

each month in which the public work labor was performed or material was delivered for which such claim was made. Written notices of the claim must be mailed by certified or registered mail. The notice must contain a sworn statement of account stating in substance that the amount claimed is just and correct and that all just and lawful offsets, payments and credits known to the affiant have been allowed. Such statement of account must include the amount of any retainage applicable to the account that has not become due. Tex. Gov't Code Ann. § 2253.041 (Vernon 1998).

#### No Written Contract

Except for a lump sum agreement, where there is no written contract, the claimant must give notice on or before the time periods listed above (depending on whether it is a subcontractor or derivative contractor). Such notices must state the (1) name of the party for whom the labor was performed or to whom the material was delivered; (2) the approximate date of performance or delivery; (3) description of the labor or materials as to reasonably identify same; and (4) amount due. Notice must include a generally itemized claim and be accompanied by copies of documents, invoices or orders sufficient to reasonably identify the labor performed or material delivered for which the claim is being made. Such documents and copies must also have a reasonable identification or description of the job and destination of delivery. Tex. Gov't Code Ann. § 2253.043 (Vernon 1998).

#### Lump Sum Agreement

Where a claim is based on a lump sum agreement, the second month and third month notices must be given in the appropriate manner depending on whether the claimant is a subcontractor or derivative contractor. Such notice must state (1) the name of the party for whom the labor was performed or to whom the material was delivered; (2) the amount of the contract;

(3) whether said contract is oral or written; (4) the amount claimed; (5) the approximate date of performance or delivery; and (6) a description of the labor or materials in such a manner as to reasonably identify the labor or materials furnished. Tex. Gov't Code Ann. § 2253.044 (Vernon 1998).

#### Unit Price Agreement

The second month and third month notices for a unit price agreement must be given within the appropriate time depending on whether the claimant is a subcontractor or derivative contractor. Whether such a unit price agreement is completed or partially completed, such notices are sufficient if the claimant attaches to the sworn statement of account a list of units and unit prices set by the contract and a statement of those completed and partially completed units. Tex. Gov't Code Ann. § 2253.045 (Vernon 1998).

#### Retainage

If a derivative claimant has entered into a contract which contains a retainage agreement, the derivative claimant must notify the prime contractor by the 15th day of the second month after the date of the beginning of the delivery of materials or the performance of the public work labor that (1) such contract provides for retainage and (2) generally the nature of the retainage. Such notice must be given by certified or registered mail to the prime contractor.

When a contract provides for retainage (whether it is a subcontractor or derivative contractor) such claimant must give written notice of the claim for such retainage to the prime contractor and its surety or sureties on or before 90 days after the final completion of the public work contract. Such written notices must be given by certified or registered mail and must consist of a statement showing (1) the amount of the contract, (2) the amount paid, if any, and (3) the balance outstanding. This notice is not required if the amount claimed is part of a prior claim

which has been made in accordance with the Texas Government Code. Tex. Gov't Code Ann. § 2253.046 - .047 (Vernon 1998).

#### Perfecting a Bond Claim

To perfect a claim against the prime contractor's bond on a public work project, claimants must give all timely notices required by the statute. Notices of an order for specially fabricated material or a notice of a retainage agreement are preliminary notices for purposes of perfecting a bond claim. The second month notice, where applicable, and the third month notice must contain all requisite information in addition to being timely filed to perfect a claim against the bond.

#### Time to File Suit on the Payment Bond

Any suit instituted by a claimant on a payment bond must be filed before the first anniversary of the date notice for a claim is mailed under the Texas Government Code. Tex. Gov't Code Ann. § 2253.078(b) (Vernon 1998).

### CONCLUSION

The mechanic's and materialman's lien laws in Texas are complex and convoluted. A general understanding of the statutes regarding public and private construction projects will enable an individual to better understand the requirements of the mechanic's and materialman's lien laws in Texas. We hope the foregoing helps you better understand these requirements and we welcome any questions you may have.

**TIMETABLE CHART  
FOR FILING  
MECHANIC'S & MATERIALMEN'S LIENS AND BOND CLAIMS**

| Month in which labor performed or materials supplied | 15th day of 2nd month | 15th day of 3rd month | 15th day of 4th month |
|------------------------------------------------------|-----------------------|-----------------------|-----------------------|
| January                                              | March 15              | April 15              | May 15                |
| February                                             | April 15              | May 15                | June 15               |
| March                                                | May 15                | June 15               | July 15               |
| April                                                | June 15               | July 15               | August 15             |
| May                                                  | July 15               | August 15             | September 15          |
| June                                                 | August 15             | September 15          | October 15            |
| July                                                 | September 15          | October 15            | November 15           |
| August                                               | October 15            | November 15           | December 15           |
| September                                            | November 15           | December 15           | January 15            |
| October                                              | December 15           | January 15            | February 15           |
| November                                             | January 15            | February 15           | March 15              |
| December                                             | February 15           | March 15              | April 15              |

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